IN THE

United States

Circuit Court of Appeals

For the Ninth Circuit

I. F. SEARLE, MINNIE A. GIBBS and MERRILL, COX & COMPANY, Creditors of the Estate of Stack-Gibbs Lumber Company, Bankrupt,
Appellants,

vs.

MECHANICS LOAN & TRUST COMPANY and THE EXCHANGE NATIONAL BANK OF SPOKANE, Creditors of Stack-Gibbs Lumber Company, Bankrupt,
Appellees.

No. 3110

IN THE MATTER OF STACK-GIBBS LUMBER COMPANY, BANKRUPT.

Upon Appeal from the United States District Court for the District of Idaho, Northern Division.

Appellees' Reply Brief

F. T. POST,
POST, RUSSELL, CAREY & HIGGINS,
Attorneys for Appellees,
Spokane, Washington.

HARRY L. COHN,
ELMER H. ADAMS,
E. C. TOURGE,
REESE H. VOORHEES, and
H. W. CANFIELD,
Attorneys for Appellants,
Spokane, Washington.

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Appellees' Reply Brief

Because of the change of position in Appellants' Reply Brief, the citation of a few additional authorities and the many misstatements of fact, we feel constrained to briefly reply thereto.

While there are many other misstatements of fact, we will refer to those appearing on pages 2, 3, 4, 5, 20, 26, 29, 30, 31, 32, 35, 36, 46, 47, 49, 50, 51 and 52 of their brief.

JURISDICTION.

Appellants cite as an additional authority the decision of the Supreme Court of Arkansas in 174 S. W., page 549. This is a suit brought in the state court for a judgment upon an order allowing the claim of the plaintiff in the bankruptcy court, on the theory that this order is tantamount to a judgment, and that while the original claim would be barred by the statute of limitations, this "judgment" is not so barred under the state statute. In other words, it purports to be a suit upon a judgment, and the contention is that the order allowing the claim is a judgment within the meaning of the statute of limitations applying to judgments. The court held (a) that the bankruptcy court did not in fact enter any judgment, and (b) that it had no power to enter such a judgment. Further comment on this case is of course unnecessary.

The language of this reply brief suggests that we did not clearly express our thought as to the nature of this proceeding. Evidently the District Court, as well as the Referee, did not misunderstand us. The expression in our brief of "equitable assignment" may not be the best way of stating the point. Our claim as asserted in the written claim and as understood by the Referee and the District Court is that the appellees or the trust company are entitled to a preference claim or lien for the whole amount claimed upon the entire estate of the bankrupt or funds representing said estate in the hands of the trustees, and that the same constitutes a first lien thereon, and in any event, that if

anyone has a prior right thereto, such persons are only the cerditors who did not sign the trust deed, and that none of the creditors who did sign the trust deed have any such prior right but that their rights are subsequent.

The procedure or machinery by which payments are to be made by the trustees to the various claimants is by way of "dividends." To illustrate: If the funds in the hands of the trustee, after the disposition of all of the property and payment of the expenses of the trust, should be $100,000 and our claim is $100,000, and if those not signing the trust deed constitute, say, 5% in amount of the claims of the creditors, and those signing the trust deed constitute, say, 95% thereof, then the appellees would get $100,000 (if their claim should be allowed as against the entire estate prior to all other claims) or would get $95,000 (in case the non-consenting creditors are allowed prior rights), and this would be worked out as a matter of procedure by way of dividends,—that is to say, as dividends are declared by the trustee. He would in one event pay all of the money to the appellees until their claim is paid in full; in the other event the dividends which would otherwise go to the signing creditors would be paid to the appellees. This is all expressly provided for by the trust deed in the paragraphs cited in our opening brief, pages 30 to 33. Paragraph 10 provides for a first and preference claim upon the entire trust estate. Paragraph 11 provides that the same "shall be paid from the proceeds of the trust estate in preference to any other claims

thereupon." Paragraph 18 provides that the trust estate shall not be distributed to the creditors until after the trustee has been repaid for advancements and expenses. Paragraph 19 provides that the advancements, expenses and compensation "shall constitute a charge upon the trust estate superior to the indebtedness of any party secured hereby."

APPELLANTS' NEW POINTS.

After concluding their discussion of "Jurisdiction" and at page 44 of Reply Brief the statement is made: "This instrument does not constitute an equitable assignment as contended for by counsel." No reason is given for that new contention. There is no argument on the subject. But counsel cite a case clearly not in point under the facts, to-wit, Christmas v. Russell, 14 Wallace 69.

We did not anticipate the raising of this question, as it was never raised before, and as under the language of the trust deed and elementary principles it seemed to us too clear for discussion. However, as the point has been raised, we will cite a few authorities illustrative of the principle.

In order to do justice and carry out the intent of the parties a court will under some circumstances hold that even a bank check constitutes an equitable assignment. Fourth Street Bank v. Yardley, 165 U. S. 634, 643.

In Walker v. Brown, 165 U. S. 654, 664, paragraph

1235, Vol. III, Pomeroy's Equity Jurisprudence, is quoted with approval as follows:

> "The doctrine may be stated in its most general form that every express executory agreement in writing whereby the contracting party sufficiently indicates an intention to make some particular property, real or personal, or fund therein described or identified, a security for a debt or other obligation, or whereby the party promises to convey or assign or transfer the property as security, creates an equitable lien upon the property so indicated, which is enforceable against the property in the hands not only of the original contractor but of his heirs, administrators, executors, voluntary assignees and purchasers or encumbrancers, with notice * * *. The ultimate grounds and motives of this doctrine are explained in the preceding section; but the doctrine itself is clearly an application of the maxim, 'Equity regards as done that which ought to be done.'"

In that case the holder of certain bonds had given to a certain creditor a letter set forth in the opinion at page 663.

Barnes v. Alexander, 232 U. S. 117, is interesting in that (a) it disapproves of the Christmas case cited by appellants, and (b) the doctrine established is set forth in the head note:

> "An obligation to pay, but definitely limited to payment out of a fund, creates a lien. There should be but one rule in this respect, and that is the one suggested by plain good sense. Where parties have a lien on a fund, they can follow it as soon as identified into the hands of others than the person originally receiving it."

In The Elm Bank, 72 Fed. 610, Judge Morrow quotes from the Christmas case a paragraph not contained in the quotation in appellants' reply brief, namely:

> "An order to pay out of a specific fund has always been held to be a valid assignment in equity and to fulfill all of the requirements of the law."

The Christmas case is cited by Judge Brewer in Schuler v. Laclede Bank, 27 Fed. 424. In this case the court holds that while a check does not ordinarily operate as an equitable assignment, nevertheless, if the drawer of the check becomes insolvent and makes a general assignment before the check is presented, then the check will operate as an equitable assignment of the amount drawn for as against the general assignee.

In Wilder v. Watts, 138 Fed. 426, the first head note is:

> "Where an alleged bankrupt, before insolvency, arranged to borrow money to purchase goods under an agreement that he would have the goods insured and assign the policies to the lenders as collateral security, and loans were made to him, the agreement operated as a valid equitable assignment of the policies, though they were not delivered when issued nor actually assigned until after loss, when the borrower was insolvent."

The Supreme Court of Alabama, in Carroll v. Kelly, 20 So. 456, citing the Christmas case, holds as set forth in the head notes as follows:

> "An agreement whereby C, a legatee, purchases the interest of K, another legatee, and agrees that the executor shall hold his interest in the

> estate as security for the payment of the consideration, and that the executor shall pay the same to K before paying to C any sum due him under the will, creates an equitable lien on the personal property under the will, but not on the real property or its proceeds to which C may be entitled under the will, but not on the real estate. On a bill to enforce such lien, the executor is a proper party."

Other illustrative state cases are:

> *Union Ins. Co. v. Glover*, 9 Fed. 529;
> *James v. Newton*, 8 N. E. 122 (Mass.);
> *Young v. Jones*, 54 N. E. 235 (Ill.);
> *Seattle v. Liverman*, 9 Wash. 276.

The Christmas case is cited in all the foregoing.

In appellants' reply brief, under the heading, "Conclusions," at page 38, they suggest another new point neither suggested in their original brief nor in their objections (Rec., p. 18) nor in their petition for review (Rec., p. 69), nor elsewhere in the record. That point seems to be that the trust deed is null and void because it was not promptly recorded and no publicity was given thereto. The good faith of the signing creditors and the trust company in making this trust deed is beyond controversy. They were not seeking to do any injury to any other creditor, present or future. Apparently the supposition was that the money advanced would be sufficient to take care of the pressing debts, exclusive of those represented by the signing creditors, and that the business could be run, if run at all, without the incurring of any new obligations. There was no intent to defraud anyone. The belief was that the assets would pay all liabilities.

There is no evidence that anyone was put in any worse position than he would have been in had this instrument not been executed.

This new position of the signing creditors may be stated thus:

> "We, creditors representing ninety per cent of the debts of this lumber company, believed that the assets exceeded the liabilities and all the creditors would be paid in full, provided the lumber company could get advancements to the amount of $100,000. We arranged with the trust company to make these advancements, and to protect the trust company we agreed that it should receive back its moneys advanced out of the trust property before any moneys were paid to us on account of our claims. We in effect assigned our claims and all our rights to the trust company to secure these advancements. To protect ourselves we selected the man to run the business under this contract. We thought that knowledge of this contract would affect the selling price of the lumber in the yard and to be manufactured and we advised the trust company not to put this contract of record. Now things have not turned out quite as well as we anticipated, and we assert in a court of conscience that the trust company cannot enforce our contract against us because the trust company obeyed our instructions."

While the distinction between "void" and "voidable" is well recognized, we sometimes find the word "void" used in the sense of voidable. An assignment for the benefit of creditors made with the intent to defraud creditors is not strictly void. It is good as between the parties but it is subject to being avoided by creditors

affected thereby so far as their interests are concerned. Of course such an instrument consented to and executed by certain creditors, while it may be avoided as to the non-consenting creditors, cannot be avoided as to the consenting creditors.

Whatever may be the rule in some jurisdictions about the necessity of recording an instrument in order to give it validity, the question is settled by statute in the State of Idaho. Section 3163, Vol. I, Idaho Revised Codes, is:

> "An unrecorded instrument is valid as between the parties thereto and those who have notice thereof."

This court held under a similar statute in California that the failure to record a mortgage given by a bankrupt until after the bankruptcy proceedings were commenced did not affect the validity of the mortgage. (In re McIntosh, 150 Fed. 546.)

The question now before us is not whether the trust company has a lien under this instrument upon the entire trust property to the detriment of the creditors who had no knowledge of the instrument, but whether it can be attacked by those who agreed to it and signed it.

Now this instrument purports to do two things: (a) create a lien upon the entire trust estate for the money advanced; (b) create a lien upon or assignment of the claims and interests of ninety per cent of the creditors for the repayment of the same money. If, perchance, the validity of this instrument as to lien "a"

is affected by the non-recording thereof so far as the non-consenting creditors are concerned, which non-recording is at the suggestion of the signing creditors, manifestly the instrument is not affected as to the same signing creditors so far as either lien "a" or "b" is concerned.

It may very well be that this idea was in the mind of the attorney for the signing creditors, Mr. H. J. Aaron, when he drew this instrument. He may have thought there might possibly arise a controversy over the lien of the trust company as against the entire fund because of his plan to keep the instrument from record, and that the trust company who was advancing the money at the instance of the signing creditors was entitled to every possible protection, and therefore the somewhat peculiar language of the different sections cited above, which provides for a lien as against and prior to the signing creditors.

In In re Mariner, 220 Fed. 542, is clearly stated the point that mere failure to record a chattel mortgage does not avoid the mortgage, *but there must be coupled with it an intent to defraud* by giving the mortgagor a fictitious credit. It is conceded that there was no such intent in the instant case.

To the same effect, see In re Moser, 224 Fed. 738, 751.

That a chattel mortgage withheld from record is fraudulent and voidable *only as to those extending credit on the faith of the grantor's apparent ownership*

free from this encumbrance, is well settled and the point has been decided by this court. Manders v. Wilson, 235 Fed. 878.

Manifestly the question first raised in the reply brief in such an offhand manner under the heading "Conclusions" is not only without merit as an abstract proposition but is one in which these appellants have no interest and cannot urge as a reason for their attempted repudiation of their contract.

MISSTATEMENTS OF FACT.

We omit so far as possible all matters referred to in our original brief.

The statement on page 3 that Mr. Coman *caused* his attorney to prepare a trust deed along the lines of the trust that was afterward consummated is incorrect.

On the same page appears the statement that the bank was the owner of bonds of the Dryad Company, "a subsidiary corporation of the bankrupt," for $100,000. The relationship between the two companies has been stated elsewhere. The amount is $92,500. *The bonds were amply secured by real estate.*

The statement at the top of page 4 that Mr. Coman called a meeting of the eastern creditors is untrue. Mr. Gibbs called the meeting of his creditors and requested Mr. Coman to go east with him. (Rec., p. 215.)

On page 5 it is said that Gibbs was "brought to the

meeting by Mr. Coman, who either by his silence or express representations" acquiesced in Gibbs' statement of facts. Wholly untrue. There is not a scintilla of evidence that Mr. Coman's conduct was other than that of absolute fairness and frankness or that he had any other knowledge than that possessed by the Fort Dearborn National Bank, the First National Bank of Nebraska, these appellants and the other signing creditors. Manifestly all these creditors would not only have introduced some evidence before the Referee, but would also be appellants now if they honestly believed any of the charges set forth in this brief.

In this connection, and before proceeding further with these misstatements of fact, we beg to call attention to a decision of this court in re Dorr, 196 Fed. 292 (in bankruptcy), wherein this court said:

> "Where the testimony is conflicting and the findings of fact of the referee and the district judge are the same, the facts will not be inquired into by an appellate court unless there is plain error."

The Circuit Court of Appeals for the Eighth Circuit in First National Bank v. Abbott, 165 Fed. 852, at 859, expressed the same thought in a bankruptcy case, as follows:

> "When the court and the referee have considered conflicting evidence and have made a finding or decree thereon, it is presumptively right and it may not be reversed unless it clearly appears that they have fallen into some error of law or have committed some serious mistake of fact in reaching their conclusion."

On page 20 appears the statement that Mr. Katz wrote no letters to any creditor except in the office of Mr. Coman, and that most of them were dictated by Mr. Coman. The record shows that Mr. Katz wrote frequent letters to Merrill, Cox & Company, Fort Dearborn National Bank, Exchange National Bank, Mechanics Loan & Trust Company and some other creditors, from his office at Gibbs, Idaho. There is no contention in the record that Mr. Coman ever saw any of these letters until received in due course of mail. Mr. Katz did, however, carry on other correspondence with the appellant, Merrill, Cox & Company, and Mr. Katz testified that he destroyed his copy of these letters. None of these letters was produced by Merrill, Cox & Company, and therefore are not in the record. To explain this peculiar transaction, Katz testified that he showed these letters to Coman before they were mailed. (Rec., p. 173.) Whether he showed *all* of them or not, we do not know, as this appellant did not produce them so that we could examine them and find out.

The statement mentioned above on page 20 is followed by another untrue statement that "everything he (Katz) did while in charge of the plant was under the direct personal supervision of Mr. Coman." This does not square with the statement contained in appellants' original brief at pages 29, 110, 112 and 113, that the trust company paid no attention to the trust and never did anything in relation thereto.

A similar false general tirade, without any evidence whatever to sustain it, is contained on page 26.

One would think on reading page 29 that there were some pages of the books of the Exchange National Bank "pasted together." There is no such evidence. The insinuation is false. The fact is that the Mechanics Loan & Trust Company had a little book called a note register and that the bookkeeper entered in that book all of the notes in question but made an error in one of his original entries and started another page and pasted two leaves together. The book was brought into court, and when some insinuation was made in relation thereto, we requested that the leaves be separated, and that was done and the same were carefully examined by counsel in open court and the whole record put in evidence, but as the exhibit afforded not even an opportunity for an insinuation, the appellants did not have it copied into the record. (Rec., pp. 265-7, 275, 289.)

The statement on pages 28 and 29 that Mr. Coman gave some testimony after he had had ample time to think over the effect thereof and in all probability had gone to his bank and inspected his records, followed by a garbled quotation from the record, is most inexcusable. The testimony on page 236, Record, shows that the next day after Mr. Coman was first on the witness stand he showed in the bank all of the bank's records to appellants' attorneys, and that afternoon he brought the same to the hearing. The *pertinent* matter in his testimony is represented *by stars* in the quotation at page 29 of their brief, except that very pertinent matter follows that quoted in the brief.

On page 30 the figures, $100,000," in the fifth line of the quotation should be $10,000." The quotation stops too suddenly and the matter following it and running into page 238 must be read to understand it.

The statement on page 31 that "it was at this point that Mr. Adams confronted the witness with these letters" is theatrical but untrue. We introduced the letters and read them into the record as a part of Mr. Coman's testimony. (Rec., p. 238.) Mr. Coman had nothing to do with this little item of interest. He said: "In regard to the added interest up to February 12th, I had nothing to do with it personally. I suppose it was handled by the note teller. I do not handle those matters myself." (Rec., p. 255.)

Page 35 of the brief says that the statement in our brief that Mr. Coman told the Minneapolis creditors about the transaction "is absolutely untrue." Mr. Coman so testified (Rec., p. 231), and there is no contradiction thereof.

A new idea is suggested at page 47. It is said that the bank, under the trust deed, would participate in the dividends as the owner of the bonds issued by the Dryad Lumber Company. No such suggestion has been heretofore made in this case. Why made at page 47 of reply brief, we know not. However, the record shows that a reference is made to these bonds in paragraph 20 of the trust deed (Rec., p. 47), also that that paragraph was amended. (Rec., p. 227.) The amendment is not in the printed record, as that paragraph has nothing to do with any issue made by the

appellants or presented either to the Referee or the District Court.

The statements contained on pages 49 and 50 are practically all untrue.

On February 22, 1916, a letter was sent to Merrill, Cox & Company and other creditors showing how the first $60,000 advanced was paid out. (Rec., pp. 150, 151.) *Neither the appellants nor any other creditor ever made any complaint.* The business was carried on for five months thereafter (including the advancement of $40,000 additional money) without any complaint of any kind from these appellants or any other creditors. Furthermore, the trust deed, in paragraph 1 (Rec., p. 40), provides that the trustee may manage the property and "incur all proper *expenses* in connection therewith as in its judgment shall seem to the best interest of all the parties hereto;" and in paragraph 2 thereof provides that the trustee may operate the mills, cut logs, etc., "and in carrying on such business it may incur such *expense* as it thinks necessary;" and in paragraph 3 thereof, that the trustee may employ such persons as it deems necessary for the management of the business "and may pay persons so employed reasonable compensation;" and in paragraph 11, that these *expenses* shall be deemed maintenance charges of the trust estate and shall be paid from the proceeds of the trust estate; and in paragraph 13, that the trustees may pay *interest* accruing upon the interest-bearing claims of the creditors.

On page 49 of the reply brief the charge is made

that the trustee paid $3000 for interest. Suppose it did. It had a right to. But the record shows it was $1000. (Rec., p. 151.)

It is said on the same page that a part of the $60,000 went to Dryad Lumber Company. The record shows that the Dryad Lumber Company ran the mill and the Stack-Gibbs Lumber Company did not have any payroll but the Dryad did, and when pay day came around the Stack-Gibbs Company turned the money over to the Dryad to meet that payroll (Rec., p. 152), and that is the item of $18,200 referred to on page 151.

It is said on page 49 that part of this money went to the Exchange Bank. Looking at the record (page 151), you will see that there was paid out $68,500, of which $60,000 was advanced by the trust company, and the remainder was received from shipments of lumber. Of this item $12,000 was bank overdrafts created in the operation of the business after February 1st, and there were *four* banks where business was done. This is but camouflage on the part of appellants and we have discussed the same in our opening brief at pages 69-70.

It is said that $7000 was paid for freight on logs. True, but if the business was run by the trustee as it had a right to run it, it must haul logs and must pay freight.

It is said that the payment made to Bardwell-Robinson and Lampert Lumber Company was because

Gibbs wanted them to get their money. No citation to the record, of course, because it is not true.

Whether or not a part of the moneys was actually advanced before the trust agreement was actually executed by the corporation bankrupt is, of course, immaterial. None of the moneys were advanced until after the instrument had been signed by all of the creditors who did sign the same, and later the whole transaction was ratified and approved at a meeting of the board of trustees and of the stockholders of the bankrupt on February 18th. Neither the bankrupt nor the signing creditors can contend that it was not advanced on the strength of the trust agreement. No one does so contend, and the correspondence shows the fact. The bankrupt and the signing creditors, having received the benefit of the moneys advanced at their instance and request and upon the strength of their signing this instrument, cannot repudiate the transaction.

The statement on page 50 that Katz was never allowed to write a letter to Chicago without having it censored by Coman is false. There is no such evidence. Appellants do not attempt to cite any. The record is filled with letters written by Katz to creditors, but it appears that Katz maintained a secret correspondence with his particular Chicago friends, Merrill, Cox & Company. He says he showed these letters to Coman. Whether he showed all of them or not, it is impossible to state, as the counsel for Merrill, Cox & Company failed to produce their corresopndence

and stated in open court that he did not have any, which is passing strange.

In their opening brief appellants stated that no debts of any kind were ever collected. No citation to the record. We referred to that in our original brief and cited the record. Appellants reiterate their original statement at page 51 of reply brief, and again, of course, without any citation because the statement is not true.

On page 51 of appellants' reply brief is the wholesale charge that the moneys were not advanced for the specific purpose named in the trust deed. The Referee and the District Court found to the contrary. This charge is not made in appellants' original brief as we pointed out in our original brief, page 62. No citation to the record is now made. It is simply another general misstatement of fact. We do not think we are called upon to discuss this question. The proof is ample. We introduced letter after letter written by Katz stating that he needed money for payroll or some other purpose. We put Katz on the witness stand. He was an adverse witness, but we showed by him how every dollar was spent in accordance with the letter and spirit of the trust deed.

In their opening brief appellants claimed that the Exchange Bank had used some $9000 of this money to pay itself an overdraft. We punctured this falsehood in our original brief. Appellants ignore it in their reply brief but come back on page 52 with a general charge that Coman (meaning the bank) repaid

himself some money, the amount not named, out of these advancements. As usual no citation to the record. Simply another misstatement.

On page 52 they italicize their statement about these creditors thousands of miles away relying upon Mr. Coman. These creditors, and especially this creditor, Merrill, Cox & Company, had a secret correspondence with Mr. Katz, who was selected for the position by themselves through their attorney, Mr. Aaron.

On page 2 of their reply brief it is stated that certain evidence was stricken, and the record is silent as to any attempt to "renew this testimony." Our answer to that is: first, the part referred to was not stricken; what the Referee attempted to strike was the statement about "secured creditors;" second, appellants recognize that it was not stricken in their original brief, page 121; third, the Referee's ruling on the question of evidence is not pertinent; the evidence must under the rules be transcribed and considered by this court. (First Nat'l Bank v. Abbott, 165 Fed. 852, 855.)

Respectfully submitted,

F. T. POST,
POST, RUSSELL, CAREY & HIGGINS,
Attorneys for Appellees.